

S E C R E T

MSGNO 31 (STXX) Z1A \*17/02/82\* \*14:49\*  
ZCZC 19:48:43Z (ST)

SECRET

82 8022570 SSP

TOR: 171803Z FEB 82

NC 8022570

PP RUEAIIB  
ZNY SSSSS ZJC STATE ZZH  
STU2839  
PP RUEHC  
DE RUEHLD #3548/01 0481302  
ZNY SSSSS ZZH  
P 171258Z FEB 82  
FM AMEMBASSY LONDON  
TO RUEHC/SECSTATE WASHDC PRIORITY 6804  
INFO RUFHOL/AMEMBASSY BONN 3152  
RUEHBS/AMEMBASSY BRUSSELS 1813  
RUFHFR/AMEMBASSY PARIS 2953  
RUEHRO/AMEMBASSY ROME 7113  
RUFHNA/USMISSION USNATO 9257  
BT

EZ1:  
S E C R E T LONDON 03548 COMBINED SECTION

EXDIS

State Dept. review completed

EZ2:  
PARIS ALSO FOR USOECD  
BRUSSELS FOR USEC  
E.O. 12065: RDS-1, 2/17/02 (STREATOR, E.J.) OR-M  
TAGS: EEWI, ESTC, EFIN, UR  
SUBJ: USSR SANCTIONS: TURNING THE PIPELINE CONTROVERSY  
TO OUR ADVANTAGE

1. (S - ENTIRE TEXT).
2. WE HAVE COMMENTED OVER RECENT WEEKS ON THE CONTROVERSY OVER U.S. EXPORT CONTROLS CONCERNING THE SOVIET GAS PIPELINE. WE REMAIN CONVINCED THAT WE MUST FIND A WAY OUT OF THIS CURRENT IMPASSE WHICH THREATENS ALLIANCE SOLIDARITY AND, IN THE LONGER RUN, OUR CAPACITY TO INFLUENCE EVENTS IN BOTH POLAND AND IN BROADER EAST-WEST RELATIONS. IT IS IMPORTANT THAT WE KEEP THE INITIATIVE AND MOVE THE ALLIANCE IN SUPPORT OF OUR GOALS TOWARD THE SOVIETS.
3. THE EUROPEANS ARE COMING TO REALIZE THAT OUR CONCERN OVER THE PIPELINE IS NOT ONLY ABOUT INCREASING THE ENERGY DEPENDENCE OF WESTERN EUROPE ON SOVIET SUPPLIES BUT ALSO ABOUT THE FOREIGN EXCHANGE EARNING CAPABILITY WITH WHICH GAS EXPORTS THROUGH THE LINE WILL ENDOW THE SOVIETS DURING THE COMING DECADE. AS WE SEE IT, THIS IS INDEED THE MAJOR ISSUE, AND, IN ANY CASE, IS MORE LIKELY TO EVOKE A POSITIVE EUROPEAN RESONANCE THAN THE ENERGY

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DEPENDENCE ARGUMENT, WHICH THEY REJECTED EVEN BEFORE POLAND.

4. THE TIME MAY AT LAST BE RIGHT TO IMPEL THE WEST TO SEIZE THIS ISSUE. THE PRESS HERE HAS DAILY REPORTS ON THE FINANCIAL PROBLEMS OF THE SOVIET EMPIRE, AND THERE IS A SENSE THAT THE SOFT CREDIT RUN THE EAST HAS ENJOYED IN THE WEST HAS, AND INDEED SHOULD, COME TO AN END. THERE IS, TOO, SOME FORBODING ABOUT WHAT THE ECONOMIC FRAGILITY OF EASTERN EUROPE PORTENDS. AND THERE JUST MAY BE A WILLINGNESS TO DEAL COLLECTIVELY AND SERIOUSLY WITH THIS ISSUE, AS BANKS AND WESTERN GOVERNMENTS DID IN THE ELEVENTH HOUR ON THE POLISH DEBT. WE WOULD NOT UNDERESTIMATE THEIR SHORTSIGHTEDNESS, NOR THE INHERENT PROBLEMS. BUT, IF WE CAN AGREE THAT SOVIET HARD CURRENCY EARNINGS IS THE PROBLEM, WE SUGGEST THE FOLLOWING AS THE ELEMENTS OF A STRATEGY FOR DEALING WITH IT.

5. OUR STRATEGY SHOULD BE TO ENGAGE THE ALLIES (AND JAPAN) IN A SERIOUS EFFORT TO IDENTIFY THE POLITICAL AND SECURITY IMPLICATIONS OF THE SOVIET EXTERNAL FINANCIAL POSITION IN THE 1980'S. WE SHOULD JOINTLY ASSESS THE EXTENT TO WHICH WE CAN AFFORD, IN SECURITY AND POLITICAL TERMS, TO LET THE SOVIETS HAVE ACCESS TO HARD CURRENCY FROM WHATEVER SOURCES: EARNINGS FROM EXPORTS OF ALL KINDS, INCLUDING ENERGY; EXPORT CREDITS FROM THE WEST; BORROWINGS ON WESTERN CAPITAL MARKETS. (WE SHOULD ALSO STUDY TRADE PATTERNS WITHIN COMECON TO DETERMINE THE EXTENT TO WHICH THE SOVIETS CAN USE INTRA-CMEA TRADE TO GAIN MORE HARD CURRENCY, OR EQUIVALENT REAL RESOURCE BENEFITS, FROM THE WEST.) DEBT RESCHEDULING FOR EASTERN EUROPEAN COUNTRIES SHOULD ALSO BE INCLUDED IN THE STUDY, WITH OUR OBJECTIVE TO GET ALLIED AGREEMENT THAT, IF EAST EUROPEAN DEBTS ARE RESCHEDULED (AS WE DID LAST YEAR FOR POLAND), WE PRESS FOR COMMITMENTS ON BILATERAL TRADE WITH THE SOVIETS TO AVOID INDIRECT RESOURCE TRANSFERS TO THE USSR, AND AN UNDERSTANDING CONCERNING THEIR HARD CURRENCY DEBTS TO THE SOVIETS.

6. CLEARLY, WE IN THE WEST WILL NEVER HAVE COMPLETE CONTROL OVER SOVIET FOREIGN EXCHANGE EARNINGS. THE SOVIETS CAN ALWAYS MAKE UP TEMPORARY SHORTFALLS THROUGH SALES OF SUCH COMMODITIES AS GOLD OR DIAMONDS, AND THE STUDY SHOULD ADDRESS THE MIX AS WELL AS LEVELS OF SOVIET INTERACTIONS ON THE MARKETS OF THE WEST.

7. POSSIBLE RESULTS OF THIS EFFORT COULD BE TO:

- -- TIGHTEN AMOUNTS AND TERMS OF CREDITS TO THE SOVIETS;

- -- LIMIT SOVIET ACCESS TO CAPITAL MARKETS BY INFLUENCING THE MARKET'S ASSESSMENT OF SOVIET ECONOMIC AND FINANCIAL PROSPECTS;

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- -- TIGHTEN CONTROLS ON WESTERN EXPORTS OF TECHNOLOGY AND EQUIPMENT;

- -- SCALE BACK ON SOVIET OPPORTUNITIES TO EARN FOREIGN EXCHANGE. THIS COULD INCLUDE LIMITING PURCHASES OF GAS THROUGH SUBSTITUTION IN THE WEST OF ALTERNATIVE ENERGY SUPPLIES; DENIAL OF MFN TARIFF RATES; USE OF DISCRIMINATORY QR'S; APPLICATION OF SPECIAL ANTI-DUMPING RULES; TIGHTENING OF SPECIAL ANTI-DUMPING RULES; TIGHTENING OF SPECIAL ANTI-DUMPING RULES;

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BILATERAL AND/OR CROSS TRADES, ETC.

8. THE LONG-RANGE OBJECTIVE SHOULD BE TO LET THE SOVIETS EARN ENOUGH FOREIGN EXCHANGE SO THAT THEY CONTINUE TO IMPORT CONSUMABLES FROM THE WEST AND TO SERVICE THEIR EXISTING WESTERN DEBT. BUT WE SHOULD ALSO TRY TO ASSURE THAT THE FINANCIAL SHOE PINCHES, AND THAT, WHEN THE SOVIETS DO BUY NON-STRATEGIC CAPITAL EQUIPMENT FROM WESTERN SUPPLIERS, IT COSTS THEM DEARLY.

9. IN EXCHANGE FOR ALLIED AGREEMENT TO EMBARK ON THIS PROJECT, WE SHOULD BE PREPARED TO MODIFY OUR EXPORT CONTROL SANCTIONS TO PERMIT WORK UNDER EXISTING PIPELINE CONTRACTS TO GO FORWARD. WE SHOULD ALSO GET ALLIED AGREEMENT TO PUT A HOLD ON FUTURE CONTRACTS PENDING FULFILLMENT OF THE CONDITIONS STIPULATED BY THE NATO MINISTERS. TO SOME EXTENT, THIS IS MAKING A VIRTUE OF NECESSITY BUT IT IS BECOMING CLEARER TO US THAT WORK ON THE PIPELINE WILL GO FORWARD WITH OR WITHOUT U.S. PRODUCTS AND TECHNOLOGY. (WE ARE REPORTING SOME DETAILS ON THIS BY SEPTEL.) IT IS CONCEIVABLE THAT THE ALLIES WOULD AGREE TO SUCH A STUDY IN THE ABSENCE OF ACTION ON THE PIPELINE, BUT THEIR WILLINGNESS TO COOPERATE IN IMPLEMENTING A TRULY EFFECTIVE STRATEGY WOULD BE MARGINAL IF WE REMAIN IN CONFLICT. WE SHOULD NOT LOSE AN OPPORTUNITY TO GET ALLIANCE AGREEMENT ON A BROAD, LONG-TERM STRATEGY WHICH CAN TURN THIS SITUATION TO OUR ADVANTAGE SIMPLY TO GAIN A RELATIVELY MODEST DELAY IN THE PIPELINE TIMETABLE. LOUIS

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